In the Supreme Court

OF THE

United States

October Term, 1979

No. 79-584

Research Equity Fund, Inc.,
Petitioner,

vs.

The Insurance Company of North America,
Respondent.

RESPONDENT'S BRIEF OPPOSING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Swaner, Leslie & Deriman
Robert E. Leslie
William Flenniken, Jr.
425 California Street
San Francisco, California 94104
Attorneys for Respondent

Robert A. Seligson
300 Montgomery Street, Suite 821
San Francisco, California 94104
Of Counsel

BOWNE-PERNAU WALSH • 1045 SANSOME ST. • S.F., CA 94111 • (415) 981-7882

SUBJECT INDEX

TABLE OF AUTHORITIES CITED

Rules and Regulations

Statutes

Text

Other Authorities

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1979

No. 79-584

RESEARCH EQUITY FUND, INC.,
Petitioner,

VS.

THE INSURANCE COMPANY OF NORTH AMERICA,
Respondent.

RESPONDENT'S BRIEF OPPOSING PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

QUESTION PRESENTED

INA respectfully submits that no question is presented, either in WGF's petition, the amicus curiae brief of the Investment Company Institute, or on the merits of the case, which requires review by this Court.

STATEMENT OF FACTS

This is an action brought by Research Equity Fund, Inc., successor by merger of Winfield Growth Fund, Inc., hereinafter called "WGF." (CT 352)[1] WGF was a pub-

[1]The abbreviation "CT" refers to the Clerk's Record, while "RT" refers to the Reporter's Transcript.

licly held, open end, diversified registered management investment company under the Investment Company Act of 1940, commonly known as a "mutual fund." (CT 352). It brought this action against Insurance Company of North America, hereinafter referred to as "INA" for declaratory relief and money damages. WGF alleged that it had sustained losses as a result of portfolio transactions and that such losses were covered by the fidelity bonds issued by INA. (CT 295). Said bonds were joint insured bonds issued on or about June 15, 1969, which remained in force until June 15, 1972. One of the joint insureds was WGF. (Ex. 8, 9, CT 352).

At the time said bonds were executed, Section 17(g) of the Investment Company Act of 1940, hereinafter referred to as Sec. 17(g) and Rule 17g-1, hereinafter referred to as Rule 17g-1[2] required WGF as a Registered Management Investment Company to provide and maintain a bond against larceny and embezzlement covering each of its officers and employees who may singly, or jointly with others, have access to securities or funds of WGF, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities. (CT 352).

Winfield & Co. was an investment adviser and managed several funds, one of which was WGF. (RT 823-824). WGF, being a mutual fund, its prinpical business was the purchase, sale and exchange of securities. (Ex. 6, pp. 1-2).

[2]Unless otherwise indicated, "Sec." refers to the Investment Company Act of 1940, 15 U.S.C. Section 80a-1, *et seq.* "Rule" refers to the S.E.C. Rules and Regulations thereunder, 17 C.F.R. Section 270, *et seq.*

On or about December 31, 1968, WGF entered into a written contract with Winfield & Co., whereby Winfield & Co. was employed by WGF as its investment adviser and would provide, among other things, investment advice and management of WGF's portfolio of securities. (Ex. 3). David Meid, R. Martin Wiskemann, Donald Hermann, and A. Stephen Sanders were employees of Winfield & Co. and assigned to manage various portfolios, including that of WGF. (RT 1597-1598, Ex. B).

Sanders was neither an officer nor an employee of WGF, but was employed by Winfield & Co. from March 1, 1968, until April 30, 1970 (F.F. 60 and 65; Ex. C). Sanders and Hermann were assigned by Winfield & Co. to their New York offices and their superior, Meid, was the chief portfolio officer and president of Winfield & Co. (RT 1550-1552, Ex. 63, p. 14). Meid terminated his position in September of 1969 and Wiskemann became Sanders' superior. (RT 402). Wiskemann was Vice President and, on occasion, Treasurer and Secretary of Winfield & Co., and also Director of Research. (RT 397-398, Ex. 4, p. 3).

Although all of the officers of WGF were also officers of Winfield & Co., the contrary was not true in that Sanders, an employee of Winfield & Co., was not an officer or employee of WGF. (Ex. 4, pp. 3-4; Ex. 6, pp. 3-4; Ex. 63, pp. 11-12; RT 1536-1540).

Sanders would make his recommendations to his superior, either Meid or Wiskemann. (RT 824-827). There was daily telephone communication between Meid and Sanders and, although not daily, a great deal of telephonic communication between Sanders and Wiskemann. (RT 1553,

402). The recommendations of Sanders (as well as others) would be recorded on a daily transaction report and such reports indicate that Sanders' recommendations required the approval of his superior at Winfield & Co. (RT 824, 828-829). The recommendation would then be forwarded to WGF and upon approval by an appropriate officer of WGF, WGF's trader would then execute the transaction, whether it be a purchase or sale of securities. (Ex. Z, AA, AB, AC, AD and AE; RT 824-825, 827, 839).

The trading department had the responsibility of selecting a stockbroker. (RT 839, 180-181). This was done by the trader by shopping about to see which stockbroker could get the best price for the particular security. The trader would then place the buy or sell order with that stockbroker. (RT 833-834).

WGF had entered into a contract with City National Bank and Trust Company (hereinafter referred to as the "custodian bank") whereby the securities and cash of the fund were held by such bank as a custodian. (Ex. 5). The authorized officers of WGF, upon approval of the confirmation from the stockbroker, would then direct the custodian bank to pay over to the stockbroker money for the purchase of the securities or, if the transaction were a sale, have the custodian deliver the securities to the stockbroker upon payment of money by the stockbroker to the custodian. (RT 346-347, 852-854). It was undisputed at the time of trial that Sanders was an employee of Winfield & Co. The offices he occupied had the title thereon Winfield & Co., and he was paid a salary by Winfield & Co. in the course and scope of his employment.

(RT 132-134, Ex. B, Ex. N, p. 5; Ex. AK, p. 5 and Ex. A, p. 6).

During the period between December, 1969, through March of 1970, John P. Galanis in concert with others engaged in the artificial manipulation of the public market price of various securities for his own personal profit and gain and during that period made payments of money to Sanders in return for Sanders causing WGF and other mutual funds to purchase some of the securities being manipulated by Galanis. The payment of money was not specifically earmarked for the recommendation of any particular security nor with any particular direction as to which particular mutual fund the security should be recommended. The recommendation of the security by Sanders was made without regard to the investment merit of the stock and Sanders profited personally from these actions. (CT 354-357). WGF contends that as a result of the activities of Sanders as described above, it suffered losses and damages.

Winfield & Co., on behalf of various corporate entities known as the Winfield complex, purchased the bonds in question through its broker, Mark F. Hopkins & Co., Insurance Brokers, Inc., (Hopkins) from INA. (RT 1531, 1136, 1138). The joint insureds under the said bonds were Winfield & Co., Winfield Distributors, Winfield Growth Fund, Winfield Underwriters, Wincap Fund, Winfield Associates, AGE Fund, Applied Financial Systems. (Ex. 8, 9). WGF was subject to the Investment Company Act of 1940, and the rules and regulations thereunder. (CT 352). During the period from January 1, 1968, to December 14,

1970, Sec. 17(g) authorized the S.E.C. to adopt rules for the bonding of a registered management investment company and the S.E.C. did in fact adopt Rule 17g-1. The pertinent texts of Sec. 17(g) and Rule 17g-1 are set forth in full in the addenda.

Neither Winfield & Co. nor its employees were required to be bonded pursuant to any rule or regulation. (15 U.S.C. Sec. 80b-1, *et seq.*). Winfield & Co., being the investment adviser and the nexus corporation of the Winfield complex, purchased the bond for various reasons, including general business purposes, and also on behalf of WGF to satisfy its bonding requirements under Rule 17g-1. (RT 276-277, 1048, 1183).

Sec. 17(g) of the 1940 Act provided in pertinent part that the registered management investment company maintain a fidelity bond covering:

> "any officer or employee of a registered management investment company who may singly, or jointly with others, have access to securities or funds of any registered investment company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities . . . against larceny and embezzlement. . . ."

Mark Hopkins was an employee of Mark F. Hopkins & Co. Insurance Brokers, Inc. (RT 1136). It handled a general line of insurance, including fidelity insurance. (RT 1137). Hopkins, acting as a broker on behalf of Winfield & Co., dealt directly with the employees of Winfield & Co. with regard to the placement of the bonds in question in this instant action. (RT 1531, 1140, 1157, 1161, 1164-1165).

He first commenced discussions with Winfield & Co. in approximately 1959 to 1962 and thereafter, talked to a series of employees responsible for ordering fidelity insurance. (RT 1138, 1157, 1164). It was Hopkins' understanding that the trading loss exclusion applied to losses sustained by a named insured through dishonest trading on the part of its employees in customers' accounts. (RT 1144). He discussed such fact with Winfield & Co. (RT 1172-1173. The coverage was renewed in 1965, 1968 and 1969. (RT 224-225).

WGF had counsel in Philadelphia who were retained for advice in connection with S.E.C. matters as well as compliance with S.E.C. requirements. (R.T. 933-935, 937, 1077-1079). Such counsel were consulted periodically concerning bonding requirements and counsel in Philadelphia on occasion sent correspondence concerning bonding requirements to WGF. (Ex. M). The duty to determine the amount, type, form and coverage of fidelity insurance to be obtained by WGF pursuant to Rule 17g-1 rested with WGF's Board of Directors and the S.E.C. (Rule 17g-1(a)). The Board of Directors relied upon their counsel in Philadelphia to satisfy the bonding requirement of Rule 17g-1. (RT 356-357, 933-935, 1077-1079).

In addition thereto, WGF retained the services of an attorney as house counsel to advise them concerning S.E.C. matters. (RT 933-935). He read the fidelity bond in question herein, including the exclusions. He appeared before the Board and discussed the fidelity bonds in question. (RT 1659-1664).

Rule 17g-1 required WGF to file a copy of the fidelity bond obtained with the S.E.C. for S.E.C. approval. Although on one occasion the S.E.C. questioned the adequacy of the amount of the bond, it did not on any other occasion challenge the sufficiency of the type, terms or coverages obtained. (RT 331-333).

WGF knew and was aware that trading loss coverage was available under the bonds, but elected not to purchase trading loss coverage. (RT 1491-1492, 1497, 1504, 1506). Cost was one of the factors in that there was a substantial premium for the purchase of trading loss coverage. (RT 295-297, 720-721, 1490, 1506).

REASONS FOR DENYING THE WRIT

Neither An Investment Adviser Nor Its Employees Need Be Bonded

WGF's contention rests upon the fallacy that a portfolio manager is a person who exists separate and apart and is something different than an investment adviser. In other words, a special relationship exists between the Fund and the so-called "portfolio manager." The term "portfolio manager" is a general term used by WGF and is not a term used by either Congress or the S.E.C. in passing the legislation or promulgating the rules. A portfolio manager is nothing more than an employee of the investment adviser who makes recommendations to the investment adviser with regard to the portfolio of the Fund which is serviced by his employer (the investment adviser) (RT 1537-1540).

WGF then carries the fallacy one step further in arguing that a portfolio manager has the authority to direct generally the disposition of securities and as such falls within the purview of both the Act and the Rule as being a person who must be bonded. To fully understand the position and authority of Sanders, some reference must be made to the facts developed at trial. Winfield & Co., the investment adviser, is a distinct corporate entity from that of WGF, the investment company. A written contract was entered into between the investment company and the investment adviser to render services to the investment company, including portfolio advice. (Ex. 3). Sanders was employed by the investment adviser and was assigned the task of doing research and making recommendations with regard to the portfolio of WGF as well as the portfolio of other funds. (RT 826). Sanders would make his recommendations to his superior, an officer of the investment adviser. (RT 824). Upon approval by the officer of the investment advisor, the recommendation would then be forwarded to WGF for its approval or rejection. (RT 824, 828-829). Upon approval of the recommendation, WGF would then order a trader in the trading department to consummate the trade. (RT 839). Such trader was an employee of the Fund whose duty it was to actually hire a broker and consummate the execution of a purchase or sale of a security.

A portfolio manager is not defined in the Investment Company Act or the rules and regulations thereunder nor is it used in connection with the bonding requirements under Section 17 or Rule 17g-1.

It is well established that a rule of statutory construction should not be used to do violence to the plain and clear meaning of the statute or to violate Congressional intent.

As stated, *inter alia*, in 73 Am.Jr.2d, *Statutes*, Section 280, page 447:

> ". . . A liberal construction of a remedial statute does not authorize the court to place such judicial construction upon the language used as to effectuate its own conception of right rather than the legislative intent or to depart from the plain and obvious meaning of the language used or to give a forced unnatural construction thereto. . . ."

Since the generic term "portfolio manager" has little if no meaning, some analysis is required of the term "investment adviser."

Section 2 of the Act contains the general definitions, and Section 2(a)(20) defines an "investment adviser." An Investment Adviser is someone other than a bona fide officer, director, trustee, member of an advisory board or an employee of the investment company. If by "portfolio manager" WGF means investment adviser, Sanders could not be the investment adviser of WGF since pursuant to Section 2(a)(20) an employee of the fund is prohibited from being the investment adviser.

Furthermore, not only is a "portfolio manager" not defined in the Act or the rules, but a portfolio manager cannot have a special relationship with the fund for it is forbidden that anyone act as an investment adviser except as set forth in the Act. Section 15(a) of the Act in effect provides that it is unlawful for any person to serve as an Investment Adviser of a fund except pursuant to a written contract, which contract has to be approved by a majority of the outstanding voting securities of the fund, and the contract must precisely describe all the compensation

to be paid. Sanders could not be the investment adviser of the fund since there was no written contract between him and the fund to act in that capacity, and he was not paid.

Both Congress and the S.E.C. recognize that an employee of the investment adviser (Sanders) is not an employee of the fund. In 1966, the S.E.C. prepared a report to Congress entitled "Public Policy Implications of Investment Company Growth."[3] It was an in-depth study, including recommendations to Congress in connection with investment companies. In it, the S.E.C. recognized that persons occupying the position such as Sander's were not employees of the fund but employees of the investment adviser. Page 87 thereof states:

> "Like typical business enterprises elsewhere in the economy, some investment companies, especially closed end companies, are internally managed by officers and staffs employed directly by the companies. As noted in Chapter 2, however, the management function of most mutual funds is contracted out to an external investment advisory organization, the principals of which are the persons who organized and promoted the fund from its inception or the successors of such persons. In such instances, the analysts and other professional personnel on whose expertise the fund relies *are employees of the advisor, not of the fund.*"

In all candor, the directors of WGF recognized that Sanders was an employee of the investment adviser and not of the fund. (RT 1537-1540).

---

[3]See, *Report of the Securities and Exchange Comm'n on the Public Policy Implications of Investment Company Growth*, H.R. Rep. 2337, 89th Cong., 2d Sess. (1966), (hereinafter "Public Policy Implications").

The "Public Policy Implications" Report by the S.E.C. was sent to Congress and, presumably Congress read the same. It appears that no change in the Section or the Act was forthcoming in connection with the S.E.C.'s opinion that persons such as Sanders are not considered by the S.E.C. to be employees of the fund and, presumably, therefore, need not be bonded pursuant to Rule 17g-1.

Congress at the time of enacting the Investment Company Act of 1940 simultaneously enacted the Investment Advisers Act. No requirements were set forth therein requiring an investment adviser to be bonded. No mention is made of a "portfolio manager" required to be bonded.

If Sanders was a covered person under Section 17(g) as contended by WGF there would be no necessity for the S.E.C. and Congress to contemplate proposed legislation amending the Investment Advisers Act of 1940 to provide substantial additional protection to investment advisory clients. In Investment Advisers Act Release No. 491, December 15, 1975 (CCH Mutual Funds Guide, ¶ 80,381, 85,893) the S.E.C. proposed legislation to amend the Investment Advisers Act of 1940.

WGF's petition suggests, at page 20, that the court below was confused as to the year that Congress considered amending the Investment Advisers Act to authorize the SEC to require bonding of investment advisers. By the SEC's Investment Advisers Act Release No. 491, dated December 15, 1975, the industry was advised of the proposed amendments in full text. It was to this 1975 SEC release that the court below referred. Hearings were held

in 1976 by the Senate Subcommittee on Securities of the Committee on Banking, Housing and Urban Affairs.

New subsection (f) of Section 208 of that Act would have authorized the S.E.C. to provide through rules and regulations such safeguards as are necessary in the public interest or for the protection of investors with respect to the financial responsibility of the investment advisers. In an accompanying letter to Congress, the S.E.C. noted the inadequacy of the investment advisers regulation and proposed amendments to provide substantial additional protection to investment advisory clients. The letter, in part, provided:

> "At the present time there are no specific requirements imposed by the act on investment advisors in order to assure that they have the financial strength necessary to carry out their functions in a manner consistent with their obligations to clients, *nor are they subject to bonding requirements to prevent losses to clients which might result from embezzlement, misappropriation, breach of duty or insolvency."* CCH, Mutual Funds Guide, ¶80,381, 85,901 (1975). [Emphasis added]

That the SEC proposed a new requirement that advisers be bonded is indicative of the legislative gap that existed at that time in that the scope of Section 17(g) and Rule 17g-1 has always been limited to those having actual access to the fund's assets, either directly or by authority to give instructions to the custodian bank. If the dishonest conduct of persons such as Sanders was intended to be included within the bonding requirements of Rule 17g-1, why would the SEC have recommended to Congress and Congress

have entertained a bill requiring bonding of an investment adviser at that time.

To ascertain who must be bonded under Section 17(g) an analysis of the Act as well as the intent of Congress and S.E.C.'s interpretation of Congressional intent is required. INA contends the proper construction to be rendered to Sec. 17(g) is as follows. Only officers and employees of the fund are required to be bonded, provided such person has access to the securities or funds (money) of the investment company, either directly, where there is no custodian so that the investment company has possession of both its securities and its funds, or where the investment company does not have possession of its securities and funds (money) because there is a custodian. (See Sec. 17(f) and Rule 17f-(a) through (d).) Bonding is still required of those officers and employees who have the authority to order or direct the custodian to release the securities or the funds. It is INA's contention that only those covered persons heretofore described must be bonded against larceny and embezzlement. The words "to direct generally the disposition of such securities" does not mean to include an employee of the investment advisor giving improper advice but is intended to include and be limited only to those officers and employees of the fund who have been authorized by a resolution of the Board of Directors to be empowered to order the custodian to release possession of the securities or the funds. INA contends that the foregoing interpretation of both the Act and the Rule is the only proper interpretation.

Prior to 1940, mutual funds represented a small section of investment business and were relatively unregulated. As WGF has pointed out, there were hearings preceding the enactment of the Investment Company Act of 1940.[4]

As a result of the 1940 hearings, Congress was aware of the problems created by the very liquid nature of the assets involved (Senate Hearings, pages 72, 125) as well as the customary relationship between an investment trust and its adviser. (Senate Hearings, pages 251-254.)

The conclusion of the court below is supported when Section 17 of the Act is read as a whole and is further supported in that the S.E.C. represented to Congress that there need not be any bonding requirements at the time the Investment Company Act was passed in 1940, because the securities were adequately protected from physical taking by the placing of the portfolio securities in a custodian account.

Although Congress authorized the S.E.C. to pass rules requiring bonding, there was no such bonding requirement until 1947. Between 1940 and 1947, the S.E.C. was satisfied that there was adequate protection by virtue of the custodial arrangements of the securities of the mutual fund. The "Senate Hearings", page 264 *et seq.*, gives a discussion of the bonding section by Mr. David Schenker, the then Chief Counsel to the S.E.C. in charge of the Investment Trust Study:

> "Mr. Schenker: We still have not recommended that it is necessary at this time to go so far [as to require bonding of officers and employees.]

[4]*Hearings on S. 3580 Before a Subcommittee of the Senate Committee on Banking and Currency,* 76th Cong. 3d Sess. (1940), (hereinafter "Senate Hearings").

Paragraph (2) of subsection (g) of Section 17 says that in the future if the situation is such that the protection of investors requires it the Commission may make rules and regulations with respect to bonding employees."

The "Senate Hearings" go on to say, at page 280, that the custodian arrangements were considered to grant sufficient safeguards at that time.

If dishonestly induced portfolio transactions by an investment adviser's employee had been intended by Congress to be included within the bonding provisions of Section 17(g), Congress would have acted to require bonding because that exposure existed prior to 1940, as well as since. If Congress had intended the words "to direct generally the disposition of such securities" to include employees of the investment advisor, a point which we do not concede, Congress would not have used the word "may" with reference to "access." Congress would have required bonding at all times and in all instances because the employee of an investment advisor would always be making investment recommendations whereas the officer or employee of the investment company may or may not have access to the securities, depending upon custodian relationships and the authority from the board of directors authorizing that particular officer or employee to be the designated person to have access.[5]

[5]Such Congressional intent is supported by the comment contained in "Public Policy Implications," page 65, footnote 206, which states:

"In its report on the bill which later became the act, the Senate Committee on Banking and Currency stated: 'Basically

Congressional intent can be ascertained by further examination of Section 17(f) which prescribes severe limitations on the possession of the securities, to prohibit the taking of such securities. If the heart of the Congressional scheme was to remedy the type of abuse committed by Sanders, to wit, dishonest portfolio recommendations Congressional enactment of custodian possession of securities would hardly prevent the sort of conduct committed by Sanders since custodian possession of securities would have no effect upon dishonest advice by the alleged "Portfolio Manager."

It should be pointed out that until 1971, there was no requirement that the cash of a mutual fund had to be kept in the possession of a custodian. This large pool of money was subject to being stolen or embezzled by officers and employees of the fund. Section 17(f) required custodial arrangements only for "securities and similar investments." It was not until 1971 that Section 17(f) was amended by Congress to require that if an investment company maintained its securities in the custody of such a bank, it must also maintain its cash assets in the custody of such bank. Thus from the time Section 17(f) was enacted, until 1971, an investment company could main-

the problems fall from the very nature of the assets of investment companies. The assets of such companies invariably consist of cash and securities, assets which are completely liquid, mobile and readily negotiable. Because of these characteristics, control of such funds offers manifold opportunities for exploitation by the the unscrupulous management of some companies. These assets can and have been easily misappropriated and diverted by such types of managements and have been employed to foster their personal interests rather than the interests of public security holders.' "

tain its cash assets outside a custodial arrangement. Section 17(g) bonding requirements protected these cash assets.

The reading of Sections 17(f), (g), (j) and 37 shows consistently what Congress intended. Section 17(f) allows a fund to have possession of its securities. Section 17(g) requires bonding against larceny and embezzlement of the fund's officers and employees who have "access" to those securities. No mention is made therein of other persons or persons who may give dishonest portfolio advice. Congress could have and would have mentioned in Section 17(g), bonding requirements to protect against improper investment advice since Congress was aware at that time of investment advisers and their employees, in that it enacted the Investment Advisers Act simultaneously therewith. Congress thereafter also enacted Section 17(j) which demonstrates Congress' intent and knowledge of improprieties available to persons capable of rendering improper portfolio advice. Section 17(j) is a prohibition against self-dealing and is not limited to employees of the fund but includes affiliated persons of the investment adviser such as Sanders. Yet when passing Section 17(j), Congress, by its silence, demonstrated its intent that the bonding requirements under Section 17(g) referred only to officers and employees of the fund and not to employees of an investment adviser.[6]

[6]There was no evidence that Sanders was an authorized person pursuant to a resolution of the Board of Directors of WCF as one of the persons who could order the custodian bank to release its securities. He was, therefore, not a person who was authorized "to direct generally the disposition of securities." Lovejoy testified that the employees of Winfield & Co. had no access to the cash or securities and that the only person who had *access* with respect to the disposition of those assets would be the Fund's officers. (RT 346-347. See also RT 852-853, Ex. 5, p. 6).

The S.E.C. amended Rule 17g-1 both in 1964 and 1974. On neither occasion did the S.E.C. see fit to require bonding beyond larceny and embezzlement, nor did it see fit to require bonding of so-called "portfolio managers." The S.E.C. recognizes that it has no authority to require the bonding of an investment advisor pursuant to Section 17(g) and, therefore, in December of 1975 requested that Congress amend the Investment Advisers Act so that the S.E.C. could require bonding of investment advisors.

The S.E.C. recognized that Congress did not intend that the investment adviser be bonded under Section 17(g) in that the S.E.C. in 1974 amended Rule 17g-1 and specifically permitted the investment adviser to be named as a joint insured along with the investment company. However, such joinder was made permissive and not mandatory. "The use of joint insured bonds by investment companies is permissive rather than mandatory." (Ex. AS, p. 1; C.L. 17).

In the 1976 Senate hearings regarding the S.E.C.'s proposed amendments to the Investment Advisers Act, the S.E.C. repeatedly stressed that there were no federal bonding requirements for investment advisers or their employees, regardless of whatever services they performed. (1976 Senate Hearings, pages 6, 7, 13, 14, 15.)

From the foregoing, it readily appears that there is no statutory requirement under the Investment Company Act of 1940, as amended, that an employee of an investment adviser be bonded. There is no statutory requirement under the Investment Advisers Act of 1940, as amended, that the employees of an investment adviser be bonded. Therefore, both the trial court and the Ninth Circuit Court

of Appeals were correct when they applied the express provisions of the "trading loss" exclusion in INA's bonds to the facts of this case. WGF received the exact coverage which it elected to purchase from INA and for which it paid a substantially lower premium than it would have paid had WGF elected to purchase trading loss coverage.

CONCLUSION

The writ must be denied.

Respectfully submitted,
SWANER, LESLIE & DERIMAN
ROBERT E. LESLIE
WILLIAM FLENNIKEN, JR.
Attorneys for Respondent

ROBERT A. SELIGSON
Of Counsel

ADDENDUM

Addendum "A"

INVESTMENT COMPANY ACT OF 1940

General Definitions

SEC. 2 (a) When used in this title, unless the context otherwise requires—

* * *

(20) "Investment adviser" of an investment company means (A) any person (other than a bona fide officer, director, trustee, member of an advisory board, or employee of such company, as such) who pursuant to contract with such company regularly furnishes advice to such company with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by such company, and (B) any other person who pursuant to contract with a person described in clause (A) regularly performs substantially all of the duties undertaken by such person described in clause (A); but does not include (i) a person whose advice is furnished solely through uniform publications distributed to subscribers thereto, (ii) a person who furnishes only statistical and other factual information, advice regarding economic factors and trends, or advice as to occasional transactions in specific securities, but without generally furnishing advice or making recommendations regarding the purchase or sale of securities, (iii) a company furnishing such services at cost to one or more investment companies, insurance companies, or other financial institutions, (iv) any person the character and amount of whose compensation for such services must be approved by a court, or (v) such other persons as the Commission may by rules and regulations or order determine not to be within the intent of this definition.

Addendum "B"

INVESTMENT COMPANY ACT OF 1940

Investment Advisory and Underwriting Contracts

SEC. 15. (a) After one year from the effective date of this title it shall be unlawful for any person to serve or act as investment advisor of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, unless in effect prior to March 15, 1940, has been approved by the vote of a majority of the outstanding voting securities of such registered company and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment by the investment adviser.

(b) After one year from the effective date of this title, it shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell or deliver after sale any security of which said company is the issuer, except pursuant to a written contract with such company, which contract, unless, in effect prior to March 15, 1940—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment by such underwriter.

(c) In addition to the requirements of subsections (a) and (b) it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, except a written agreement which was in effect prior to March 15, 1940, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved (1) by a majority of the directors who are not parties to such contract or agreement or affiliated persons of any such party, or (2) by the vote of a majority of the outstanding voting securities of such company.

(d) It shall be unlawful for any person—

(1) to serve or act as investment adviser of a registered investment company, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as investment adviser thereunder; or

(2) as principal underwriter for a registered open-end investment company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, pursuant to a written contract which was in effect prior to March 15, 1940, after March 15, 1945, or the date of termination provided for in such contract, whichever is the prior date, or after assignment thereof subsequent to March 15, 1940, by the person acting as principal underwriter thereunder:

Provided, however, That the limitation to March 15, 1945, shall not apply in either case if prior to that date such contract is renewed in such form that it complies with the requirements of subsection (a) or (b) of this section, as the case may be, and is approved in the manner required by this section in respect of a contract of the same character made after March 15, 1940.

(e) In the case of a common-law trust of the character described in subsection (b) of section 16, either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a

meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 2 (a) as to a majority shall be applicable to the vote cast at such a meeting.

(f) Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

Addendum "C"

INVESTMENT COMPANY ACT OF 1940

SEC. 17

* * *

(f) Every registered management company shall place and maintain its securities and similar investments in the custody of (1) a bank having the qualifications prescribed in paragraph (1) of section 26 (a) for the trustees of unit investment trusts; or (2) a company which is a member of a national securities exchange as defined in the Securities Exchange Act of 1934, subject to such rules and regulations as the Commission may from time to time prescribe for the protection of investers; or (3) such registered company, but only in accordance with such rules and regulations or orders as the Commission may from time to time prescribe for the protection of investers. Rules, regulations, and orders of the Commission under this subsection, among other things, may make appropriate provision with respect to such matters as the earmarking, segregation, and hypothecation of such securities and investments, and may provide for or require periodic or other inspections by any or all of the following: Independent public accountants, employees and agents of the Commission, and such other persons as the Commission may designate. No such member which trades in securities for its own account may act as custodian except in accordance with rules and regulations prescribed by the Commission for the protection of investers.

(g) The Commission is authorized to require by rules and regulations or orders for the protection of investers that any officer or employee of a registered management

investment company who may singly, or jointly with others, have access to securities or funds of any registered company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities (unless the officer or employee has such access solely through his position as an officer or employee of a bank) be bonded by a reputable fidelity insurance company against larceny and embezzlement in such reasonable minimum amounts as the Commission may prescribe.

* * *

(j) It shall be unlawful for any affiliated person of or principal underwriter for a registered investment company or any affiliated person of an investment adviser of or principal underwriter for a registered investment company, to engage in any act, practice, or course of business in connection with the purchase or sale, directly or indirectly, by such person of any security held or to be acquired by such registered investment company in contravention of such rules and regulations as the Commission may adopt to define, and prescribe means reasonably necessary to prevent, such acts, practices, or courses of business as are fraudulent, deceptive or manipulative. Such rules and regulations may include requirements for the adoption of codes of ethics by registered investment companies and investment advisers of, and principal underwriters for, such investment companies establishing such standards as are reasonably necessary to prevent such acts, practices, or courses of business.[1]

[1]Subsection (j) added, eff. December 14, 1970, Public Law 91-547, sec. 9(c), 84 Stat. 1421.

Addendum "D"

INVESTMENT COMPANY ACT OF 1940

Larceny and Embezzlement

SEC. 37. Whoever steals, unlawfully abstracts, unlawfully and willfully converts to his own use or to the use of another, or embezzles any of the moneys, funds, securities, credits, property, or assets of any registered investment company shall be deemed guilty of a crime, and upon conviction thereof shall be subject to the penalties provided in section 49. A judgment of conviction or acquittal on the merits under the laws of any State shall be a bar to any prosecution under this section for the same act or acts.

Addendum "E"

Rule 17f-1. Custody of Securities With Members of National Securities Exchanges

(a) No registered management investment company shall place or maintain any of its securities or similar investments in the custody of a company which is a member of a national securities exchange as defined in the Securities Exchange Act of 1934 (whether or not such company trades in securities for its own account) except pursuant to a written contract which shall have been approved, or if executed before January 1, 1941, shall have been ratified not later than that date, by a majority of the board of directors of such investment company.

(b) The contract shall require, and the securities and investments shall be maintained in accordance with the following:

(1) The securities and similar investments held in such custody shall at all times be individually segregated from the securities and investments of any other person and marked in such manner as to clearly identify them as the property of such registered management company, both upon physical inspection thereof and upon examination of the books of the custodian. The physical segregation and marking of such securities and investments may be accomplished by putting them in separate containers bearing the name of such registered management investment company or by attaching tags or labels to such securities and investments.

(2) The custodian shall have no power or authority to assign, hypothecate, pledge or otherwise to dispose of any such securities and investments, except pursuant to the direction of such registered management company and only for the account of such registered investment company.

(3) Such securities and investments shall be subject to no lien or charge of any kind in favor of the custodian or any persons claiming through the custodian.

(4) Such securities and investments shall be verified by actual examinations at the end of each annual and semi-annual fiscal period by an independent public accountant retained by the registered management investment company, and shall be examined by such accountant at least one other time, chosen by him, during the fiscal year. Certificates of such independent public accountant stating that he has made an examination of such securities and investments, and describing the nature of the examination, shall be transmitted to the Commission promptly after each such examination.

(5) Such securities and investments shall, at all times, be subject to inspection by the Commission through its employees or agents.

(6) The provisions of (1), (2) and (3) shall not apply to securities and similar investments bought for or sold to such investment company by the company which is custodian until the securities have been reduced to the physical possession of the custodian

and have been paid for by such investment company: *Provided,* That the company which is custodian shall take possession of such securities at the earliest practicable time. Nothing in this subparagraph shall be construed to relieve any company which is a member of a national securities exchange of any obligation under existing law or under the rules of any national securities exchange.

(*c*) A copy of any contract executed or ratified pursuant to paragraph (*a*) shall be transmitted to the Commission promptly after execution or ratification unless it has been previously transmitted.

(*d*) Any contract executed or ratified pursuant to paragraph (*a*) shall be ratified by the board of directors of the registered management investment company at least annually thereafter.

Addendum "F"

Rule 17f-2. Custody of Investments by Registered Management Investment Company

(*a*) The securities and similar investments of a registered management investment company may be maintained in the custody of such company only in accordance with the provisions of this rule. Investments maintained by such a company with a bank or other company whose functions and physical facilities are supervised by Federal or State authority under any arrangement whereunder the directors, officers, employees or agents of such company are authorized or permitted to withdraw such investments upon their mere receipt, are deemed to be in the custody of such company and may be so maintained only upon compliance with the provisions of this rule.

(*b*) Except as provided in paragraph (*c*), all such securities and similar investments shall be deposited in the safekeeping of, or in a vault or other depository maintained by, a bank or other company whose functions and physical facilities are supervised by Federal or State authority. Investments so deposited shall be physically segregated at all times from those of any other person and shall be withdrawn only in connection with transactions of the character described in paragraph (*c*).

(*c*) The first sentence of paragraph (*b*) shall not apply to securities on loan which are collateralized to the extent of their full market value, or to securities hypothecated, pledged, or placed in escrow for the account of such investment company in connection with a loan or other transaction authorized by specific resolution of its board

of directors, or to securities in transit in connection with the sale, exchange, redemption, maturity or conversion, the exercise of warrants or rights, assents to changes in terms of the securities, or other transactions necessary or appropriate in the ordinary course of business relating to the management of securities.

(d) Except as otherwise provided by law, no person shall be authorized or permitted to have access to the securities and similar investments deposited in accordance with paragraph *(b)* except pursuant to a resolution of the board of directors of such investment company. Each such resolution shall designate not more than five persons who shall be either officers or responsible employees of such company, and shall provide that access to such investments shall be had only by two or more such persons jointly, at least one of whom shall be an officer; except that access to such investments shall be permitted (1) to properly authorized officers and employees of the bank or other company in whose safekeeping the investments are placed and (2) for the purpose of paragraph *(f)* to the independent public accountant jointly with any two persons so designated or with such officer or employee of such bank or such other company. Such investments shall at all times be subject to inspection by the Commission through its authorized employees or agents accompanied, unless otherwise directed by order of the Commission, by one or more of the persons designated pursuant to this paragraph.

(e) Each person when depositing such securities or similar investments in or withdrawing them from the depository or when ordering their withdrawal and delivery from the safekeeping of the bank or other company, shall sign a notation in respect of such deposit, withdrawal or order which shall show (1) the date and time of the deposit, withdrawal or order, (2) the title and amount of the securities or other investments deposited, withdrawn or ordered to be withdrawn, and an identification thereof by certificate numbers or otherwise, (3) the manner of acquisition of the securities or similar investments deposited or the purpose for which they have been withdrawn, or ordered to be withdrawn, and (4) if withdrawn and delivered to another person the name of such person. Such notation shall be transmitted promptly to an officer or director of the investment company designated by its board of directors who shall not be a person designated for the purpose of paragraph *(d)*. Such notation shall be on serially numbered forms and shall be preserved for at least 1 year.

(f) Such securities and similar investments shall be verified by complete examination by an independent public accountant retained by the investment company at least three times during each fiscal year, at least two of which shall be chosen by such accountant without prior notice to such company. A certificate of such accountant, stating that he has made an examination of such securities and investments and describing the nature and extent of the examination shall be transmitted to the Commission by the accountant promptly after each examination.

Addendum "G"

Rule 17g-1. Bonding of Officers and Employees of Registered Management Investment Companies

(a) Each registered management investment company shall provide and maintain a bond which shall be issued by a reputable fidelity insurance company, authorized to do business in the place where the bond is issued, against larceny and embezzlement, covering each officer and employee of the investment company, who may singly, or jointly with others, have access to securities or funds of the investment company, either directly or through authority to draw upon such funds or to direct generally the disposition of such securities (hereinafter referred to as "covered persons"). The bond may be in the form of an individual bond for each covered person or a schedule or blanket bond covering all covered persons; shall provide that it shall not be cancelled, terminated or modified except after written notice shall have been given by the acting party to the affected party and to the Commission not less than 30 days prior to the effective date of cancellation, termination or modification; and shall be in such reasonable amount as a majority of the board of directors of the investment company who are not covered persons shall determine, with due consideration to the value of the aggregate assets of the investment company to which any covered person may have access, the type and terms of the arrangements made for the custody and safekeeping of such assets, and the nature of securities in the company's portfolio. This determination shall be made at least once each year. Notwithstanding any such determination the Commission may in any case, by order

after appropriate notice and opportunity for hearing, prescribe reasonable minimum amounts of coverage, with reference to the type and form of the bond or bonds for each covered person or each class of covered persons.

(b) Each registered management investment company shall—

(1) File with the Commission within 10 days after the execution of the bond or any amendment thereof (i) a copy of each resolution of the board of directors of the investment company determining the amount, type, form and coverage of each such bond, (ii) a statement as to the period for which the premiums for each bond have been paid, and (iii) a copy of each such bond and each amendment thereto, and

(2) File with the Commission, in writing, within 5 days after the making of a claim under the bond by the investment company, a statement of the nature and amount thereof, and

(3) File with the Commission, within 5 days of the receipt thereof, a copy of the terms of the settlement of any claim made under the bond by the investment company, and

(4) Notify by registered mail each member of the board of directors of the investment company at his last known residence address of (i) any cancellation, termination or modification of the bond, not less than 20 days prior to the effective date of cancellation, termination, or modification and (ii) the filing and of the settlement of any claim under the bond by the investment company, at the time the filings required by subparagraphs (2) and (3) of this paragraph are made with the Commission.

(c) Each registered management investment company shall designate an officer thereof who shall make the filings and give the notices required by paragraph *(b)* of this rule.

(d) The information set forth in the filings required by subparagraphs (2) and (3) of paragraphs (*b*) of this rule shall not be made available to the public unless and except insofar as the Commission finds that public disclosure of the whole or any part thereof is necessary or appropriate in the public interest or for the protection of investors.

(e) Where the registered management investment company is an unincorporated company managed by a depositor or investment adviser, the terms "officer" and "employee" shall include, for the purposes of this rule, the officers and employees of the depositor or investment adviser.

(f) Not later than 1 year from August 1, 1964, arrangements between registered management investment companies and fidelity insurance companies which would not permit compliance with the provisions of this rule shall be modified by the parties so as to permit such compliance.